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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 1410

MIDWESTERN GAS TRANSMISSION COMPANY, EAST TENNESSEE NATURAL GAS COMPANY, *Petitioners*,

v.

FEDERAL POWER COMMISSION, ET AL., *Respondents*.

On Petition for a Writ of Certiorari to the United States Court Court of Appeals for the Seventh Circuit

JOINT REPLY OF PETITIONERS TO MEMORANDUM OF FEDERAL POWER COMMISSION IN OPPOSITION

Of Counsel:

JACK WERNER
DALE A. WRIGHT
HAROLD L. TALISMAN
Littman and Werner
1001 Connecticut Avenue
Washington, D. C. 20036

FRANK E. BARNETT
Valley Fidelity Bank Building
Knoxville, Tennessee

HARRY A. BEGLEY
38 S. Dearborn Street
Chicago, Illinois

HARRY S. WELCH
W. C. BRADEN, JR.
P. O. Box 2511
Houston, Texas 77001

HARRY S. LITTMAN
MELVIN RICHTER
Littman and Werner
1001 Connecticut Avenue
Washington, D. C. 20036

Attorneys for Petitioners

June 12, 1968

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The Federal Power Commission (Commission) does not deny either the importance of the question presented or the serious potential adverse effect of its ruling upon the long-term financial integrity of companies subject to its regulation if its forecast proves to be inaccurate. Instead, in urging against certiorari, the Commission contends that its decision was correct on the merits. However, the arguments advanced in support thereof are misleading and unsound, and do not come to grips with the basic question presented by the Petition herein.

1. Contrary to the Commission's assertion (Memo. pp. 4-5), neither *Alabama-Tennessee Natural Gas Co.* v. *F.P.C.*, 359 F.2d 318 (5th Cir. 1966), certiorari denied, 385 U.S. 847 (1966), nor *City of Chicago* v. *F.P.C.*, 385 F.2d 629 (D.C. Cir. 1967) certiorari denied, *sub nom, Public Service Commission of Wisconsin* v. *F.P.C.*, 390 U.S. 945 (1968), established any principle that liberalized depreciation results in a tax saving. Rather, the Court of Appeals in these cases merely deferred to the factual findings there made by the Commission as supported by the requisite evidence. However, the Fifth Circuit in *Alabama-Tennessee* made clear its disagreement with the choice made by the Commission; in addition to expressly characterizing these findings by the Commission as constituting merely a choice among "competing economic guesses" (359 F.2d at 339), that court emphasized its qualms with regard to the validity of that choice, and the risks and uncertainties inherent therein, by admonishing (*Ibid.*):

> "* * * The Commission must, of course, concern itself with the possibility of having misread the future and with the future's taking a turn without benefit of advice from the Commission. All things change * * *."

2. Similarly unfounded is the Commission's further assertion (Memo. p. 5) that this alleged principle "is not seriously contested here." As expressly pointed out in the Petition (at pp. 15-16), not only have eminent authorities and responsible agencies taken the opposing view, but so also had the Commission itself —prior to its about-face in *Alabama-Tennessee*. Indeed, as recently as its Brief filed with the court below, the Commission still acknowledged (at p. 29) that "it must be candidly conceded that differences of

opinion do exist * * * *" among experts as to the risks associated with taking liberalized depreciation. It is because the managements of Midwestern and East Tennessee disagreed with these views of the Commission that they undertook to revert to straight line tax depreciation following the Commission's decision in *Alabama-Tennessee.*

3. Nor is the Commission correct in asserting (Memo. p. 5, p. 6 fn. 10) that Petitioners claim an unfettered right in the selection of tax depreciation methods. Petitioners do not question the Commission's authority to disallow expenses which are wasteful, dishonest or an abuse of discretion (see Petition pp. 11-13). However, it is firmly established that the decisions as to expenditures are primarily the responsibility of management unless demonstrated to be imprudent.[1] This is particularly the case with regard to the method of tax depreciation to be used. It is management—not the Commission—which is most familiar with the company's operations and financial affairs and which has the responsibility for the financial integrity of the company. In these circumstances it is improper for the Commission (by a bare majority of one) to undertake to set aside management's decision to use straight line tax depreciation merely because the majority of the Commission, had it been management,

[1] Contrary to the suggestion of the Commission (Memo. p. 6), both *Southwestern Bell Telephone Co.* v. *Comm'n,* 262 U.S. 276 (1923) and *West Ohio Gas Co.* v. *Comm'n,* 294 U.S. 63 (1935) involved future rates for a regulated company. In each of these cases, this Court was concerned with the future, the references to the company's past expenditures, which the Commission would now highlight, were solely to provide a basis for forecasting future expenditures. Yet in each case, the regulatory commission's disallowance of these projected expenses was set aside as invading the prerogatives of management.

would have acted differently in view of the choice made by that majority among "competing economic guesses."

The controlling principle, we submit, is whether management's decision was reasonable when evaluated in light of the materials and factors considered by it. As pointed out in the Petition, the managements of Midwestern and East Tennessee did not share the Commission's faith in its speculative forecasts as to their long-term growth prospects. In addition, they were fearful that should the Commission's forecasts not work out as projected by it, the result might well be seriously to impair the long-term financial integrity of their companies. Since this fear was based on an admittedly reasonable, although different, view of the future than that currently espoused by the Commission, there is no basis, under the applicable standards, to set aside the management's decision based thereon.[2]

4. Finally, it should be noted that not only are the interests of the investors as well as those of the consumers to be considered in determining the public interest (see, e.g., *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)), but the effect of the decisions of the companies' management is not to deprive the consumers of any long-term "economies of operations and tax savings." (See FPC Memo. p. 5). The fact is that the companies' net

[2] The Commission's attempt to distinguish its earlier decisions in *United Gas Pipe Line Co.*, 31 F.P.C. 1180, and *Wisconsin Michigan Power Co.*, 31 F.P.C. 1445 (Memo, p. 7 fn. 12) is unfounded. The Commission's decisions in those cases made no reference to the lack of showing on which the Commission would now distinguish these cases. *Per contra*, the Commission there expressly relied on the existence of a discretion in management to choose among the tax depreciation options provided by Congress. See 31 F.P.C. at 1457-1458, 31 F.P.C. at 1191, 1238.

earnings will not be increased by their taking straight-line tax depreciation instead of liberalized depreciation with flow through, and hence the consumers will not in any case pay more than the companies' actual cost of service. As pointed out by Commissioner Bagge in this regard (R. 470):

> "* * * The protection of the long range interests of the consumer is dependent upon the financial integrity of the public utilities which serve him. In this regard his interests are closely allied with those of the millions of people who have invested billions of dollars in public utilities, accepting a smaller return than would otherwise be possible because they seek greater security of investment. The investors deserve some protection too. The risk to both consumer and investor is too great, the stakes too high, to wave aside the very real danger they face in order to grant to only one of them what is, at best, a short-range benefit, and what may, in the long run, be no benefit at all."

WHEREFORE, for the foregoing reasons as well as those set out in the Petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

Of Counsel:

JACK WERNER
DALE A. WRIGHT
HAROLD L. TALISMAN
Littman and Werner
1001 Connecticut Avenue
Washington, D. C. 20036

FRANK E. BARNETT
Valley Fidelity Bank Building
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Attonreys for Petitioners

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